(34,071)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

No. 762

CARL H. KOTHE, TRUSTEE, PETITIONER,

vs.

R. C. TAYLOR TRUST

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MAY 13, 1929

[fol. 1] [Caption omitted]

IN UNITED STATES DISTRICT COURT, DISTRICT OF MASSACHUSETTS

No. 39889. In Bankruptcy

In the Matter of HERBERT TURKEL, Bankrupt; In re Appeal of R. C. TAYLOR TRUST

PROOF OF UNSECURED DEBT—Filed with Referee April 3, 1928

At Worcester, in said District of Massachusetts, on the — day of March A. D. 1928 came Frank F. Butler, of Worcester in the County of Worcester and State of Massachusetts, attorney (or authorized agent) of the R. C. Taylor Trust of Worcester in the County of Worcester and State of Massachusetts and made oath and says that Herbert I. Turkel, the person by (or against) whom a petition for adjudication of bankruptcy has been filed, was at and before the filing of said petition, and still is, justly and truly indebted to the said R. C. Taylor Trust in the sum of five [fol. 2] thousand and 00/100 (50,000) dollars; that the consideration of said debt is as follows: damages for breach of lease in the amount of $5,000, that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term. The lease under which the bankrupt occupied provided that "the filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

That no part of said debt has been paid; and that this deponent has not, nor has any person by his order, or to this deponent's knowledge or belief, for his use had or received any manner of security for said debt whatever. And this deponent further says, that he is duly authorized by his

principal to make this affidavit, and that it is within his knowledge that the aforesaid debt was incurred as and for the consideration above stated, and that such debt, to the best of his knowledge and belief, still remains unpaid and unsatisfied.

R. C. Taylor Trust, by Frank F. Butler, Trustee.

Subscribed and sworn to before me this thirtieth day of March A. D. 1928. George S. Taft, Justice of the Peace.

May 26, 1928. Disallowed after hearing.
Daniel W. Lincoln, Referee.

IN UNITED STATES DISTRICT COURT

PETITION TO REFEREE FOR REVIEW

To Daniel W. Lincoln, Esq., Referee in Bankruptcy:

Your petitioner respectfully shows:

That your petitioner claims that the bankrupt was at the filing of his petition in bankruptcy, and still is, indebted to it in the sum of five thousand ($5,000);

[fol. 3] That your petitioner duly filed a proof of debt for said amount, the nature of the claim and the consideration of said debt being set forth in said proof of claim;

That upon May 26, 1928 the following order was made on said proof of claim: "May 26, 1928. Disallowed after hearing. Daniel W. Lincoln, Referee";

That such order was and is erroneous as matter of law, there being no question but that the facts were as set forth in said proof of debt.

Wherefore your petitioner, feeling aggrieved because of such order, prays that the same may be reviewed, as provided in the bankruptcy law of 1898 and General Order XXVII.

Dated at Worcester, Mass., May 29, 1928.

R. C. Taylor Trust, by Frank F. Butler, Trustee, Petitioner.

Duly sworn to by Frank F. Butler. Jurat omitted in printing.

IN UNITED STATES DISTRICT COURT

REFEREE'S CERTIFICATE ON REVIEW—Filed June 14, 1928

I, Daniel W. Lincoln, referee in bankruptcy in charge of this proceeding, do hereby certify:

In the course of such proceeding there was filed on April 3, 1928 by the R. C. Taylor Trust a proof of debt for five thousand dollars ($5,000), that the consideration of said debt is as follows:

[fol. 4] "damages for breach of lease in the amount of $5,000, that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term. The lease under which he bankrupt occupied provided that 'the filing of any petition in bankrutcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof.' "

That on the twenty sixth day of May 1928 I dissallowed said claim after hearing, for the reason that the proof is based on damages for the amount of rent running from the date of the filing of the petition to the end of the term of the lease, no part of such claim being for any rent which had accrued at the time of the filing of said bankruptcy petition.

That on the twenty-ninth day of May 1928 the petitioner, the R. C. Taylor Trust, feeling aggrieved at my order, filed a petition for review.

That the error complained of by the petitioner was that the order was erroneous as a matter of law, there being no question but that the facts were as set forth in said proof of debt.

I attach to this certificate the petition for review.

And said question is certified to the judge for his opinion thereof.

Dated at Worcester, the eighth day of June, A. D. 1928.

Daniel W. Lincoln, Referee in Bankruptcy.

In United States District Court

Decree—June 26, 1928

At Boston, in said District, on the twenty-sixth day of June, A. D. 1928, upon the question certified to the court by the referee in said matter on the fourteenth day of June, [fol. 5] A. D. 1928, now, therefore, after hearing arguments of George S. Taft, Esq., counsel for the R. C. Taylor Trust, and of Frank H. Pardee, Esq., counsel for the Trustee in Bankruptcy, and after due consideration of the same;

It is hereby ordered and decreed that the order of the referee dissallowing the claim of the R. C. Taylor Trust be and it hereby is affirmed.

It is further ordered that the clerk send a copy of this ordered by mail to the referee.

Witness the Honorable James A. Lowell, Judge of said court, and the seal thereof, this twenty-sixth day of June, A. D. 1928.

Mary E. Prendergast, Deputy Clerk. (Seal.)

In United States District Court

Memorandum—June 26, 1928

Lowell, J.:

Petition for a review of the disallowance by Mr. Referee Lincoln of a claim in the sum of five thousand dollars for rent under a lease which contained the following clause:

"The filing of any petition in bankruptcy * * * shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the lessor, this lease shall become and be terminated and, * * * the lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

This case differs from the unreported case of in the matter of Farley v. McNeill, in which an unreported opinion was filed by me on July 15, 1925. In that case the clause in the lease required the damages sustained by the landlord to be determined in a manner therein prescribed, namely: "an

amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of the term."

[fol. 6] In the present case if the claim is allowed the landlord may prove for the entire amount and then re-let the premises, perhaps at a higher rent.

Petition dismissed.

IN UNITED STATES DISTRICT COURT

PETITION FOR APPEAL BY R. C. TAYLOR TRUST AND ORDER ALLOWING SAME—Filed July 17, 1928

To the Honorable James A. Lowell, District Judge of the United States District Court for the District of Massachusetts:

The petitioner, the R. C. Taylor Trust, conceiving itself aggrieved by the final order and decree entered on the twenty-sixth day of June 1928, in the above-entitled proceeding, dismissing the petition, does hereby petition for an appeal from said order and decree to the United States Circuit Court of Appeals for the First Circuit, and prays that his appeal may be allowed and a citation granted, directed to Carl H. Kothe, the trustee, commanding him to appear before the United States Circuit Court of Appeals for the First Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings and evidence in said proceeding, duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the First Circuit.

R. C. Taylor Trust Petitioner. George S. Taft, Solicitor for Petitioner.

The foregoing appeal is hereby allowed. James A. Lowell, D. J.

IN UNITED STATES DISTRICT COURT

ASSIGNMENT OF ERRORS—Filed July 17, 1928

Now comes the R. C. Taylor Trust, petitioner, and files the following assignment of errors on appeal from order of this court dated June 26, 1928:

First. That the United States District Court for the District of Massachusetts erred in dismissing the petition.

[fol. 7] Second. That the order of the referee disallowing the petitioner's claim was erroneous as a matter of law, there being no question but that the facts were as set forth in the proof of claim; that consequently the United States District Court erred in not allowing the petition for review.

R. C. Taylor Trust, by George S. Taft, Solicitor for Bankrupt.

In United States District Court

Waiver of Bond on Appeal—Filed July 17, 1928

Now comes Carl H. Kothe, trustee of the above-entitled bankrupt, and waives his right to a bond on appeal by the R. C. Taylor Trust from order dismissing its petition for review.

Carl H. Kothe, Trustee.

In United States District Court

Præcipe for Transcript of Record—Filed July 19, 1928

To the Clerk of the United States District Court for the District of Massachusetts:

You are hereby requested to make a transcript of record to be filed in the United States Circuit Court of Appeals for the First Circuit pursuant to an appeal allowed in the above-entitled proceeding, and to include in such transcript the following:

1. Proof of unsecured debt.
2. Petition to referee for review.
3. Referee's certificate.
4. Opinion of court.
5. Decree or order.
6. Petition for appeal.
7. Assignment of errors.

8. Citation on appeal.
9. Waiver of bond.
10. Præcipe.

George S. Taft, Solicitor for Petitioner.

[fol. 8] Service of above præcipe admitted this nineteenth day of July, 1928, and assent.

Frank H. Pardee, Solicitor for Trustee.

Citation, in usual form, showing service on Carl H. Kothe, omitted in printing.

[fols. 9 & 10] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 11] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT, OCTOBER TERM, 1928

No. 2273

R. C. TAYLOR TRUST, Creditor, Appellant,

v.

CARL H. KOTHE, Trustee, Appellee

Appeal from District Court of the United States for the District of Massachusetts

Before Bingham, Johnson, and Anderson JJ.

OPINION—January 8, 1929

JOHNSON, Circuit Judge:

This is an appeal from an order of the District Court of the United States for Massachusetts.

The R. C. Taylor Trust leased, April 20, 1927, to Herbert I. Turkel certain real estate for a term of two years, to being May 15, 1927. The rent reserved was $4,000 per year

payable in equal monthly payments in advance. The lease contained the following provision:

"The filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

[fol. 12] Turkel afterwards was adjudged a bankrupt, but just when the petition was filed upon which adjudication was made does not appear in the record.

The lessor later filed a proof of claim for damages amounting to $5,000, which was the rent reserved in the lease for the residue of the term thereof—1¼ years.

The referee disallowed the claim and upon petition for review the District Court sustained the referee and dismissed the petition.

It is well settled law in this circuit that a claim for rent accruing after the filing of a petition in bankruptcy is not a provable claim. The quoted provision in the lease was clearly inserted for the purpose of enabling the lessor in the event of bankruptcy to protect itself to some extent against the loss of rent for the term of the lease remaining after the filing of a petition in bankruptcy. Under it the filing of a petition in bankruptcy, either by or against the lessee, was made to constitute a breach of the lease which at once was terminated. No rent could accrue after its termination. For the breach of the lease the lessor was entitled to damages. These damages are fixed as the amount of the rent reserved under the lease. The claim presented by the lessor is therefore not for rent but for damages to which he is entitled under this provision of the lease. The rent reserved for the balance of the term was employed by the parties to measure the damages to which the lessor was entitled. They were not dependent upon contingencies which render rent to accrue not a provable claim because not absolutely due at the time of the filing of the petition in bankruptcy. They were made absolutely payable simultane-

ously with the filing of the petition in bankruptcy. See Statement of Lowell, Circuit Judge, in In re Pettingill, 137 Fed. 143, 146, where it is said: "For admission to proof, however, the claim need not arise before bankruptcy, nor need the contract be broken theretofore. It is sufficient for proof if the breach of contract and bankruptcy are coincident."

Judge Putnam, in In re Swift, 112 Fed. 315, 321, in discussing whether a claim that did not arise until the filing of a petition in bankruptcy was a provable claim, uses this lan-
[fol. 13] guage: "The contract ripened simultaneously with the beginning of the proceedings in bankruptcy, as the consequence thereof in connection with the adjudication which followed. Of course, as everything related back to the filing of the petition, the ripening of the claim did not occur before it was filed, nor afterwards, but simultaneously with it, as already said." See also Central Trust Company v. Chicago Auditorium Association, 240 U. S. 581, where the Supreme Court quotes with approval the language of Judge Lowell in In re Pettingill, supra; and also In re Mullings Clothing Company, 238 Fed. 58, 67.

It will be noted that the provision in question makes the lease to terminate and does not provide that it shall be forfeited upon the filing of a petition in bankruptcy. If forfeited it might call for some action upon the part of the lessor, but it is here provided that without any entry or action by the lessor "the lease shall become and be terminated." It cannot be said that the amount of damages to be recovered is so largely in excess of any actual damage that the lessor may suffer that it must have been intended as a penalty and its recovery would be unconscionable.

The term of the lease was short—two years. While there is nothing in the record to disclose that it was necessary for the lessor to expend considerable money in the preparation of the property for the use to which the lessee might wish it devoted, it is not an unreasonable inference that it did so. It is true that if the claim is allowed it will diminish the dividends to be paid to other creditors, but we are not concerned with this result. The only question presented upon this record is whether or not the claim made by the lessor is a provable one under Section 63 (a) 4 of the Bankruptcy Act of 1898.

It is contended by the trustee that the provision above cited was intended to operate as a penalty and not to fix the amount to be paid as liquidated damages. Whether an agreement to pay a fixed sum of money for a default in the performance of a contract is a penalty or liquidated damages depends upon the intention of the parties. Morrill v. Weeks, 70 N. H. 178, 180, and cases there cited; Sun Printing & Publishing Association v. Moore, 183 U. S. 642, 669; [fol. 14] United States v. Bethlehem Steel Co., 205 U. S. 105, 119; Guerin v. Stacy, 175 Mass. 595, 597; Lynde et al. v. Thompson, 2 Allen 456.

A well known exception to this test is where the promise or agreement is to pay a large sum of money in the event of a default in the payment of a much smaller sum, in which case the law makes interest the measure of damages for failure to pay money when it is due, and will not permit parties to avoid the usury laws in this way. Mead v. Wheeler, 13 N. H. 351; Morrill v. Weeks, supra. In other words such a contract, because of the usury laws, is construed as for a penalty or security beyond which damages cannot be recovered.

In the case now before us the contract or promise is not to pay a larger sum of money for a much smaller fixed sum, nor a sum as damages larger than is apparent from all the circumstances would cover actual damage; and its language plainly indicates that the parties intended that the sum agreed to be paid, in case of a breach, should be liquidated damages and not a penalty.

There is no evidence from which it could be found that the actual damages sustained by the claimant (the lessor) were less than those agreed upon, and that those agreed upon were increased or made greater by padding those that would probably be sustained.

As the agreement is one for liquidated damages, can it be said to be invalid as being a fraud on the creditors of the bankrupt (the lessee), or a preferential transfer or conveyance?

There is no evidence that the bankrupt intended to defraud his creditors or that the claimant knew of such intention, if it existed. It is, therefore, not void on that account.

It does not appear that the bankrupt was insolvent when the lease was made; and the covenant in regard to damages, if it could be said to effect a preferential transfer, was plainly not made within four months of the filing of the petition in bankruptcy.

The analogies suggested in the brief of the creditor arising in cases of leases of personal property where by their [fol. 15] terms the whole amount becomes due in case of default are not applicable to real property where by the terms of the lease the parties have fixed with certainty the damages to be recovered upon its breach or, what amounts to the same thing, determined the method of their certain ascertainment.

The decree of the District Court is reversed and the case is returned to that court for further action not inconsistent with this opinion, the appellant to recover costs to be paid from the assets of the bankrupt.

IN UNITED STATES CIRCUIT COURT OF APPEALS

DISSENTING OPINION

ANDERSON, J. (dissenting):

This is an important case. The doctrine now laid down by the majority opinion opens a wide door for schemes to nullify the Bankruptcy Act.

The real case is not stated in that opinion with entire accuracy and clarity. The record is short. The only evidence is the sworn proof of claim that the bankrupt is "justly and truly indebted * * * in the sum of five thousand and 00/100 (5,000) dollars * * * damages for breach of lease in the amount of $5,000, that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term. The lease under which the bankrupt occupied provided that 'the filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this

lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof.' "

The referee simply certified "that the facts were as set forth in said proof of debt." Neither the date nor the term of the lease is stated. For those my brethren resort to the briefs. There was no claim or ground for claim that the provision for damages equivalent to rent could be sustained as liquidated damages because "the term of the lease was [fol. 16] short," and the lessor might have expended "considerable money" in adapting the leased property to the bankrupt's use. There is neither evidence nor presumption that the lessor made any such expenditure. The case presented and argued is that such provision for transmuting non-accrued rent into damages makes a claim provable against the lessee's bankrupt estate; whatever the term, whenever bankruptcy comes, and without regard to actual damage suffered. Appellant's learned counsel frankly and correctly cenceded at the argument that, if this claim is provable, a like claim under a lease for forty years, terminated by the lessee's bankruptcy at the end of one year, would be provable. And for present purposes a lease is no different from many other kinds of contracts. The ruling now made would support a claim arising under a long term contract to furnish goods, deliveries and payments to be made periodically in installments,—by inserting a stipulation that the bankruptcy of the purchaser should, ipso facto, be held a breach remitting the seller to damages equal to the price of the undelivered goods. The seller would keep his undelivered goods and have a provable claim equal to the selling price thereof. So also in a contract for personal services, running for years,—the bankruptcy at any time of the employer may be made to remit the employee to a provable claim for damages equal to the remainder of his compensation for the whole period.

In this actual case and in both of the hypothetical cases, it is quite possible that the bankruptcy of the lessee, purchaser or employer work no damage whatever to the other party. Here, for aught we know, the lessor may have immediately relet at an increased rent, after getting rent in advance for a month during which he had the premises. In

the hypothetical case of the sale of goods, the seller may have resold at a higher price the goods contracted to the bankrupt. In the hypothetical case of personal services, the employee may have profited from the termination of his contract and the resultant opportunity for more lucrative employment. If, in the absence of all evidence, there is any presumption that the breach of such contracts works any damage at all, there is certainly neither presumption nor [fol. 17] probability that such damage equals the balance accruing under the contracts thus terminated, so that the suppositious victim of a breach is released from his recurrent obligations thereunder. In other words, such stipulations ground claims for damages purely artificial and having no sensible or approximate relation to the realities of the varying situations; in dominant aspects they provide for penalties assessable, not upon the party in default, but upon his creditors.

Illustrations might be multiplied indefinitely. Compare Van Iderstein v. National Bank, 227 U. S. 575, 582; 4 Remington (3d Ed.) section 1527.

In my view, such contracts are, on their face and in essential nature, in fraud of future creditors of the prospective bankrupt. They are agreements by prospective bankrupts to give the other parties to these contracts dividends belonging, in whole or in large part, to the bankrupts' real creditors; they import intent to defraud. They contemplate padding claims in order to prevent other creditors from having the benefit of the equality provisions of the Bankruptcy Act. In effect, they provide for proving false claims; for prospective bankrupt and creditor to agree that the creditor's claim shall be magnified in order to give him assets belonging beneficially to other creditors has exactly the same effect on the rights of those other creditors as creating a claim ab initio from nothing. Analyzed, both are attempts to get other people's money by false representations.

In another aspect this provision was for a penalty,—not for liquidated damages. The intent of the parties is only one test in the ordinary case involving only the rights of the parties to the agreement,—frequently disregarded if the result thus reached be illegal or unconscionable. 17 C. J. p. 936, and cases cited. But when, as here, the intent is,—not to pay from the property of the party breaking the

contract, but from property of others, the intent condemns the contract; it does not validate it. The cases cited in the majority opinion rest on the principle that parties sui juris may contract to do as they like with their own. In this case the parties undertook to contract or damages payable [fol. 18] from an estate belonging beneficially in no part to the breaker of the contract; on adjudication the entire estate vested beneficially in the creditors.

In another aspect, this is nothing but an agreement for proving non-accruing rent by simply calling it damages; it assumes that the courts may be beguiled by an alias into disregarding realities. I can find no authority whatever for upholding such an obvious scheme of fraud upon the Bankruptcy Act.

[fol. 19] In United States Circuit Court of Appeals

Clerk's Certificate

On January 8, 1929, this cause came on to be heard, and was fully heard by the court, Honorable George H. Bingham, Honorable Charles F. Johnson and Honorable George W. Anderson, Circuit Judges, sitting.

Thereafter, to wit, on February 18, 1929, the opinion of the court (page 11) and a dissenting opinion (page 15) were filed, and the following Final Decree was, entered:

Final Decree—February 18, 1929

This cause came on to be heard January 8, 1929, upon the transcript of record of the District Court of the United States for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now, to wit, February 18, 1929, here ordered, adjudged and decreed as follows: The decree of the District Court is reversed, and the case is returned to that court for further action not inconsistent with the opinion passed down this day, the appellant to recover costs to be paid from the assets of the bankrupt.

By the Court.

Arthur I. Charron, Clerk.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER STAYING MANDATE

Thereafter, to wit, on February 18, 1929, upon motion of appellee, mandate was stayed until further order of court.

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 20] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed April 15, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the First Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 34,071. United States Circuit Court of Appeals, First Circuit. Term No. 762. Carl H. Kothe, trustee, petitioner, vs. R. C. Taylor Trust. Petition for writ of certiorari and exhibit thereto. Filed March 11th, 1929. File No. 34,071.

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Supreme Court of the United States.

October Term, 1928.

No. 748

CARL H. KOTHE, Trustee,
APPELLEE, PETITIONER HEREIN,

v.

R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

In the Matter of
Herbert Turkel, Bankrupt.

Petition for Writ of Certiorari and Brief in Support of Petition.

FRANK H. PARDEE,
Attorney for Petitioner.

ADDISON C. GETCHELL & SON, LAW PRINTERS, BOSTON.

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Supreme Court of the United States.

OCTOBER TERM, 1928.

No.

CARL H. KOTHE, TRUSTEE,
APPELLEE, PETITIONER HEREIN,
v.
R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF
HERBERT TURKEL, BANKRUPT.

PETITION FOR WRIT OF CERTIORARI TO ISSUE TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice of the Supreme Court of the United States and the Honorable Associate Judges thereof:

The petitioner, Carl H. Kothe, respectfully represents to this Honorable Court as follows:

1. The petitioner is the duly elected trustee in bankruptcy of the estate of Herbert Turkel, bankrupt. On April 20, 1927, the respondent entered into an agreement with the bankrupt to lease certain premises, described as a store and basement, No. 186 Front Street, Worcester, Massachusetts, commencing on the 15th day of May, 1927, for the full term of two years. The bankrupt agreed to pay rent

at the rate of $4000 yearly by equal monthly instalments. The bankrupt entered into and occupied the leased premises and paid rent under the lease until December, 1927, when an involuntary petition in bankruptcy was filed. No rent has been paid under the lease after January 15, 1928. The lease contained the following provision:

> "The filing of any petition in Bankruptcy . . . by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

2. This case arises from the fact that on April 3, 1928, the respondent filed with the referee a proof of debt (Rec. p. 1) for $5000, the amount of rent reserved in the lease from the last payment made under the lease to May 15, 1929, the date of expiration. The respondent by its representative re-entered the premises very soon after the filing of the petition, and has been in possession ever since.

3. The authority under which the jurisdiction of this Honorable Court is invoked is by virtue of the provisions of section 25 (*d*) of the Bankruptcy Act of 1898 and the amendments thereof.

4. The questions involved in this case, as stated in the dissenting opinion of Judge Anderson, are: *first,* whether the contract in question is on its face and in essential nature in fraud of future creditors of the prospective bankrupt, providing for proving false claims; *second,* whether the provision of the lease in question is a provision for a penalty, and not for liquidated damages.

5. Judge Lowell, in the District Court, sustained the ruling of the referee, who disallowed the proof of debt and aptly said: "If the claim is allowed the landlord may prove for the entire amount and then re-let the premises, perhaps at a higher rent." Upon appeal by the respondent the Circuit Court of Appeals for the First Circuit reversed the decree of the District Court dismissing the petition. Judge Anderson filed a dissenting opinion and in forceful and logical language (Rec. p. 15) agreed with the trustee's contention, the ruling of the referee, and the decree of the District Court.

6. The petitioner respectfully submits to this Honorable Court that his petition should be allowed for the following reasons:

(1) The questions involved in the case are questions of far-reaching importance to mercantile and business interests which have not been, but should be, settled conclusively by this Court.

(2) The said Circuit Court of Appeals by the majority opinion has laid down a doctrine which is untenable and in conflict with the weight of authority and the applicable decisions of this Court as to call for the exercise of this Court's power of supervision.

(3) The decision of said Circuit Court of Appeals is in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit; in consequence it is desirable that the rule of law applicable be definitely and finally established by this Court.

Wherefore the petitioner respectfully prays that a writ of certiorari may be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the First Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record of all of the proceedings in this cause, to the end that said cause may be reviewed and de-

termined by this Court, as provided by law, and that it may have such other and further relief as to this Honorable Court may seem appropriate and in conformity with law.

Frank H. Pardee.

Attorney for Petitioner.

I hereby certify that I am counsel for the petitioner herein, Carl H. Kothe; that in accordance with the request of said petitioner and the referee in bankruptcy, Daniel W. Lincoln, Esquire, the foregoing petition has been prepared; and that the allegations contained in said petition are true to the best of my knowledge and belief; and that said petition is, in my opinion, well founded in law and in fact, and should be granted.

COMMONWEALTH OF MASSACHUSETTS.

COUNTY OF SUFFOLK, ss. BOSTON, MASSACHUSETTS

Then personally appeared Frank H. Pardee of Boston, Massachusetts, and made oath that he prepared and signed the foregoing petition and that the same is prepared with the consent of and in accordance with the request of the petitioner named therein, and that the allegations contained in said petition are true to the best of his knowledge and belief.

Before me,

Carl H. Kothe

Notary Public.

My commission expires April 20, 1929.

Supreme Court of the United States.

OCTOBER TERM, 1928.

No.

CARL H. KOTHE, TRUSTEE,
APPELLEE, PETITIONER HEREIN,
v.
R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF
HERBERT TURKEL, BANKRUPT.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

Statement of the Case.

The proceedings in this case are shown in full in the record and described, we believe, in sufficient detail in the petition (Pet. pars. 1 and 2).

The authority under which the jurisdiction of this Court is involved is stated in paragraph 3 of the petition.

The facts of the case are set forth as certified by the referee in said proof of claim (Rec. p. 3), but are more fully set forth in paragraphs 1 and 2 of the petition.

The controversy has reference to whether the provision in the lease under which the bankrupt occupied; namely:

> "The filing of any petition in bankruptcy—by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and

> without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor, shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof"—

makes the lease on its face and in essential nature in fraud of future creditors of the prospective bankrupt, and an attempt to nullify the Bankruptcy Act; and whether the provision is for a penalty, not liquidated damages.

Statement of the Question at Issue.

The specific questions, therefore, which the petitioner respectfully submits for the decision of this Honorable Court may be stated as follows:

Is the provision in the lease in essential nature in fraud of future creditors of the prospective bankrupt?

Is the provision in the lease for a penalty, and not for liquidated damages?

The Grounds for the Petition for Certiorari.

The grounds upon which the petitioner appeals to this Honorable Court for a writ of certiorari to the said Circuit Court of Appeals for the First Circuit are as stated in the petition, and are as follows:

SUMMARY OF ARGUMENT.

I. The questions involved in this case are questions of far-reaching importance to mercantile and business interests which have not been, but should be, settled conclusively by this Court.

II. The said Circuit Court of Appeals by the doctrine laid down by the majority opinion is untenable and in con-

flict with the weight of authority and the applicable decisions of this Court, and calls for the exercise of this Court's power of supervision.

III. The decision of said Circuit Court of Appeals is in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit; in consequence it is desirable that the rule of law applicable be definitely and finally established by this Court.

Argument.

Point 1.

The question involved in the case is a question of far-reaching importance to mercantile and business interests which has not been, but should be, settled conclusively by this Court.

First. Judge Anderson in the first sentence of his dissenting opinion says: "This is an important case." By the decision of this case the status of contracts which tend to nullify the Bankruptcy Act will be determined. Although a lease is involved in the present case, the application of the principles of law involved are no different from any contract, for purchase and sale, for personal services, or whatnot. The determination of the question involved affects the entire business and mercantile world. It is common knowledge that most businesses are conducted in leased premises, and on a credit basis. The future creditors of businesses, whether such businesses are operated by corporations or by individuals, who are in the eyes of the Bankruptcy Act prospective bankrupts, should know what is the status of a contract such as the one in question, which is in essential nature a fraud on creditors.

Therefore your petitioner respectfully submits to this Honorable Court that the question involved is of great importance to mercantile and business interests, and it has not been, but should be, settled conclusively by this Court.

Point 2.

The said Circuit Court of Appeals by the doctrine laid down by the majority opinion is untenable and in conflict with the weight of authority and the applicable decisions of this Court so as to call for the exercise of this Court's power of supervision.

First. The provision of the lease under which the landlord, respondent, seeks to prove his claim is: "and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof." As Judge Anderson has so aptly said in his dissenting opinion (Rec. p. 18): "This is nothing but an agreement for proving non-accruing rent by simply calling it damages; it assumes that the Courts may be beguiled by an alias into disregarding realities." If "rent" were substituted for "damages" in the aforequoted provision of the lease, the decisions of the Circuit Courts of Appeals uniformly hold that the claim is not provable, so that the following is said to be the rule, in 4 Remington (3d), sec. 802: "If the landlord accepts the surrender of the leasehold or forfeits the residue of the term upon the bankruptcy, he waives his right to a claim for the rent for the unexpired portion of the term; for the Lessor cannot both have back his property and at the same time present a claim for the future installments of rent, and if he re-enters the premises or re-takes possession of the property so as permanently to exclude the Lessee from all future use thereof or otherwise terminate the lease, naturally, cannot prove for the future installments." *Wilson* v. *Pennsylvania Trust Co.*, 114 Fed. 742 (C.C.A. 3); *Rosenbloom* v. *Uber*, 256 Fed. 584 (C.C.A. (3); *In re Roth & Appel*, 181 Fed. 667 (C.C.A. 2); and *In re Miller Bros. Grocery Co.*, 219 Fed. 851 (C.C.A. 6).

Second. In another aspect of this question the provision in the lease was for a penalty, and not liquidated damages,

and the doctrine laid down by the majority opinion of said Circuit Court of Appeals favors a forfeiture or penalty which is contrary to well-established principles of law. The conclusion of the majority of said Court of Appeals is that the language in the lease plainly indicates that the parties intended that the sum agreed to be paid in case of a breach should be liquidated damages, and not a penalty. It is respectfully submitted that the intention of the parties to the contract is not the sole test of whether the sum stated in the contract is a provision for liquidated damages or a penalty. *Gay Manuf. Co.* v. *Camp,* 65 Fed. 794; *Lampman* v. *Cochran,* 16 N.Y. 275; *Tayloe* v. *Sandiford,* 7 Wheat. 13; and *Sun Printing & Publishing Association* v. *Moore,* 183 U.S. 642. Even if the Court ascertained beyond a doubt that the intention of the contracting parties was to regard the future rent as liquidated damages, the Court should further inquire, it is respectfully submitted, whether the enforcing of such provision would reach the element of exorbitance (*Maryland Dredging Co.* v. *United States,* 241 U.S. 184), illegality, or fraud.

As was said in *United States* v. *Bethlehem Steel Co.*, 205 U.S. 105, at page 119: "When such intention [intention of the contracting parties] is ascertained it is ordinarily the duty of the Court to carry it out." In all the cases where the Courts have enforced the contract, even though the case seemed a hard one, the person against whom the agreement was sought to be enforced was one of the contracting parties. The attention of the Court is respectfully invited to the fact that in this case the lessee is not the one who will suffer by the enforcement of this provision, but his innocent creditors, whose goods constitute the major portion of his estate, and who, in the contemplation of the Bankruptcy Act, are entitled to receive equitable distribution of the bankrupt's estate. It is further respectfully submitted that the elements of fraud and deception are so patent that the Courts should not countenance the enforcement of

a contract of this nature. *Maryland Dredging Co.* v. *United States, supra.*

Peckham, J., says in *United States* v. *Bethlehem Steel Co., supra:* "The Courts at one time seemed to be quite strong in their views and would scarcely admit that there ever was a valid contract providing for liquidated damages. Their tendency was to construe the language as a penalty, so that nothing but the actual damages sustained by the party aggrieved could be recovered." Although the attitude of the Courts, it would seem, has changed as to contracting parties, it is respectfully submitted that, where the rights of innocent third persons are involved and it is a matter for equitable distribution of a bankrupt estate, the attitude of the Court should be as Peckham, J., says it formerly was when the Courts were construing the contract as between the contracting parties.

Therefore the petitioner repectfully submits to this Honorable Court that the said Circuit Court of Appeals for the First Circuit has decided the case in a way that is untenable and in conflict with the weight of authority and the applicable decisions of this Court so as to call for the exercise of this Court's power of supervision.

Point 3.

The decision of said Circuit Court of Appeals is in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit; in consequence it is desirable that the rule of law applicable be definitely and finally established by this Court.

First. The Circuit Court of Appeals for the Sixth Circuit had exactly the same question to decide in the case of *In re Miller Bros. Grocery Co.*, 219 Fed. 851 (C.C.A. 6) as was decided in this case. The Miller Bros. Grocery Company and the Lamson Consolidated Store Service Company executed on November 15, 1911, a contract under which the Grocery Company had installed a cash-carrier system by

the Store Service Company. The lessee was to use the system on its premises for seven years from the date of installation. The lessee was to pay rental quarterly in advance on the 1st days of March, June, September, and December in each year at the rate of $250 per annum. January 19, 1912, the lessee paid the rental for the time between the date of installation and March 1st; on that date the first quarterly instalment became payable (in advance); but that sum was not paid, nor was anything further paid on account of rent. On May 16, 1912, an involuntary petition in bankruptcy was filed against the Grocery Company. Adjudication followed, and a trustee was duly elected. During August, 1912, the Lamson Company took possession of the carrier and removed it, and, on August 26, 1912, after removing the carrier, filed its proof of debt, including in its proof the total rental for the seven years, less the payments made. The referee disallowed the claim, and upon review the District Court reversed the order of the referee and allowed the entire claim.

Says Warrington, J., at page 852:

> "The question is whether the Lamson Company was entitled both to take back the carrier system and insist upon allowance of its entire claim. The lease provides:
>
> "Paragraph 3 '. . . If any installment of rental shall remain unpaid for 60 days after it becomes due, the entire rental to the end of this lease shall become at once payable without demand.'
>
> "Paragraph 6 'And these presents are upon this condition that in case of a breach by Lessee of any of the covenants or agreements herein, or in case the Lessee becomes bankrupt, insolvent or makes an assignment for the benefit of creditors, or discontinues business in the premises for any other reason whatsoever, the balance of rental for the entire term of this lease shall be considered at once due and payable without notice or demand on the part of the Lessor; and it

is also provided that the Lessor may at any time after such breach of this lease occurs, enter the premises, take possession of said system, and thereby terminate all rights and interests of the Lessee in said system.' "

At page 853. "It results that the Lessor's theory savors of forfeiture of substantial rights of the Lessee, and it need not be said that forfeitures are not favored. It is conceded that, if the subject of the lease were real estate, re-entry of the Lessor would put an end to the Lessee's liability to pay unearned rent; and it ought to follow that if the instrument in issue is to be treated as a lease, a like conclusion should be reached here."

The decision of the District Court was reversed.

Although, because of certain aspects of *In re Miller Bros. Grocery Co., supra,* the language quoted might be considered dictum, that the Court did not so intend it is shown by its opinion in *Lamson Co.* v. *Elliott, Taylor, Woolfenden Co. et al.,* 25 Fed. (2d) 4 (C.C.A. 6). At page 6 says Denison, J.:

"The decision of this Court in the Miller case might well be considered as critically depending upon the conclusion that the two rights were alternatively given, and so it might be thought that what is said about invalidity through the forfeiture element was dictum; and yet the discussion and conclusion as to the validity of a promise to pay the remaining payments in spite of re-entry, were persuasive in leading the Court to take the final step, and we are not inclined to disregard, as merely dicta the things said about validity."

Therefore it is respectfully submitted that the conflict between the decisions of the First and Sixth Circuit Courts of Appeals upon the identical questions of law is apparent;

and this Honorable Court, never having had occasion to settle the question, should now settle it definitely and finally.

Conclusion.

It is most respectfully submitted to this Honorable Court that the question involved in this case is of great importance in the administration of the Bankruptcy Act and of great interest to the mercantile and business interests; that there is conflict between two Circuit Courts of Appeals thereon; that this case was decided by a divided Court, Judge Anderson filing a dissenting opinion, full of forceful and logical language and reasoning; that in view of these aspects of the case as well as the disagreement between the District Court and the Circuit Court of Appeals, and for all the other reasons above pointed out, it is respectfully submitted that the writ of certiorari should issue; that the decree of the Circuit Court of Appeals for the First Circuit should be reversed, and that of the District Court affirmed.

Respectfully submitted,
FRANK H. PARDEE,
Attorney for Petitioner.

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CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

NO. 48

CARL H. KOTHE, Trustee,

APPELLEE, PETITIONER HEREIN,

v.

R. C. TAYLOR TRUST,

APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF

HERBERT TURKEL, Bankrupt.

BRIEF FOR THE RESPONDENT

IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

GEORGE S. TAFT,
Attorney for Respondent.

T. HOVEY GAGE,
Of Counsel.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

NO. 762

CARL H. KOTHE, Trustee,

APPELLEE, PETITIONER HEREIN,

v.

R. C. TAYLOR TRUST,

APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF

HERBERT TURKEL, Bankrupt.

BRIEF FOR THE RESPONDENT

IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

GEORGE S. TAFT,
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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929

NO. 762

CARL H. KOTHE, TRUSTEE,
APPELLEE, PETITIONER HEREIN,

v.

R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF
HERBERT TURKEL, Bankrupt.

Brief for the Respondent,

IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

I. THE OPINION OF THE COURT BELOW.

The case in the Court below is reported in *30 Fed. (2d) 77.*

II. STATEMENT OF THE CASE.

The bankrupt was a lessee of the respondent, under a two year lease expiring May 15, 1929, at $4000 per year. Prior to the bankruptcy, the rent had been paid up to Feb. 15, 1928. Prior to said date, the petition in bankruptcy was filed.

The lease contains this provision:

> "the filing of any petition in bankruptcy . . . . . by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall

> forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof." (Record, P. 4.)

The respondent presented before the Referee a "proof of unsecured debt" for $5000, the consideration of said debt being

> "damages for breach of lease in the amount of $5,000, that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term." (Record, P. 2.)

The Referee disallowed the claim. A petition for review was disallowed by the District Court. (Record, P. 5.) The decree of the District Court was reversed. Opinion by Johnson, Circuit Judge, Anderson, J. writing a dissenting opinion (Record, Pp. 11–18).

The petitioner contends in his supporting brief (1) that the question involved is one of "far reaching importance," (2) that the opinion of the Circuit Court of Appeals is "in conflict with the weight of authority," and (3) that the decision is "in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit."

III. ARGUMENT.

Summary of the Argument.

Point A. The question involved is not of the "far-reaching importance" contended for by the petitioner.

Point B. The claim was a demand in existence at the filing of the petition. It was not contingent. The petitioner makes no contention that the claim, if valid in other respects, was contingent.

Point C. The opinion is not "in conflict with the weight of authority." The claim presented is not for "rent," but for damages. The agreement was not a "penalty."

Point D. The decision is not in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit cited in petitioner's brief.

POINT A.

The single matter decided is that the claim for damages by a lessor of real estate under the lease in question, against the bankrupt estate of his lessee may be allowed, where the lease provides that the filing of a petition by or against the lessee shall be deemed to constitute a breach of the lease, and that thereupon the lease shall be terminated, and where the parties have agreed in the lease that the damages for such breach shall be measured by the amount of rent reserved in the lease for the residue of the term.

Furthermore, in the instant case the lease was for only two years and the rental only $4000 per year. The opinion points out (Record, P. 13) that "The term of the lease was short—two years." The decision goes no further than to hold that in a *two-year lease* containing the provision above cited, the lessor has a provable claim. It would not *necessarily* follow that the lessor would have a provable claim regardless of the length of the lease and the portion thereof remaining unexpired at the time of the bankruptcy of the lessee.

POINT B.

The cases cited in the opinion on page 12 of the Record and at the top of page 13, make it clear that the damages are not dependent upon any contingency. It is not like the case of a lease which provides that upon bankruptcy of the lessee, the lessor *may enter and terminate the lease*, with a further provision concerning damages in such event. (*Slocum v. Soliday, 183 Fed. Rep. 410.*) The distinction is clearly pointed out in *Cotting v. Hooper, 220 Mass. 273 at 276.*

The petitioner makes no contention in his supporting brief that the claim is "contingent" in nature.

POINT C.

The petitioner contends (P. 8 of Brief) that "this is nothing but an agreement for proving non-accruing rent by simply

calling it damages" quoting from the dissenting opinion (Record, P. 18), and cites numerous cases holding that a lessor may not both retake the property and prove a claim for "future installments of rent." It is clear that "Rent issues from the land, is not due until the rent day, and is due in respect of the enjoyment of the premises let." *Filene's Sons Co. v. Weed, 245 U. S. 497.* The difference, however, between "rent," which is a technical word, and damages measured by rent is clearly pointed out in the opinion.

> "For the breach of the lease the lessor was entitled to damages. These damages are fixed as the amount of the rent reserved under the lease. The claim presented by the lessor is therefore not for rent but for damages to which he is entitled under this provision of the lease. The rent reserved for the balance of the term was employed by the parties to measure the damages to which the lessor was entitled." (Record, P. 12).

As is said by Holmes, J. in *Filene's Sons Co. v. Weed, supra:*

> "The contract was not that all the rent for the term should become presently due, it was not for rent at all, but was a personal covenant that liquidated the damages upon a footing that was familiar and fair."

The petitioner contends that "the provision in the lease was for a penalty, and not liquidated damages." (Petitioner's Brief, P. 8, Second.)

It may be noted at the outset that it is not by any means an altogether one-sided agreement. The lessor, for the privilege of proving a claim for damages and receiving a dividend from the lessee's estate, if there be assets, agrees that bankruptcy shall terminate the lease, and thereby *gives up* all his rights against the lessee himself. In some cases the continuing liability of the lessee would doubtless be worth more to the lessor than his vacant property plus the right to prove his claim for damages. Hence in some of the reported decisions, the question has arisen by an attempt of the lessor

to expunge a claim from the bankrupt's schedule of liabilities, where it has been listed.

In re Cushman, 3 Fed. (2d) 449.

The Court knows nothing of the considerations which may have led the parties to make the provision.

The opinion *suggests* (Record, P. 15) that it is not an unreasonable inference that the lessor may have spent "considerable money in the preparation of the property for the use to which the lessee might wish it devoted." It could be equally well suggested that the insertion of the provision was one of the determining factors in fixing the amount of rent, or that because of the provision the lessor did not insist upon any guarantor of the rent. But whatever may have been the considerations, the "language plainly indicates that the parties intended that the sum agreed to be paid, in case of a breach, should be liquidated damages and not a penalty," quoting from the opinion (Record, P. 14).

The question is "whether the intention was to provide for a fixed measure of damages or only to stipulate for a penalty." Bigelow, C. J. in

Lynde & Another v. Thompson, 2 Allen 456, 459.

> "We heartily agree with the Court of Appeals in England that so far as precedent permits the proper course is to enforce contracts according to their plain meaning and not to undertake to be wiser than the parties, and therefore that in general when parties say that a sum is payable as liquidated damages they will be taken to mean what they say and will be held to their word." Holmes, C. J. in

Guerin v. Stacy, 175 Mass. 595, 597.

> "This whole subject is reviewed in *Sun Printing & Pub. Assoc. v. Moore, 183 U. S. 642, 669* . . . . . where a large number of authorities upon this subject are referred to . . . . . The question always is, What did the parties intend by the language used? When

such intention is ascertained it is ordinarily the duty of the Court to carry it out." Peckham, J. in

U. S. v. Bethlehem Steel Co., 205 U. S. 105.

In *Bedard v. Ransom, Inc., 241 Mass. 74,* there was a so-called lease of a truck. The contract called for an initial payment and regular monthly payments thereafter. It provided that upon failure of the lessee to make any regular payment "all sums then remaining unpaid shall at once become due and payable." It also provided that upon such failure, the lessor might repossess itself of the truck, and retain all payments which had been made. The Court says of such a contract:

> "A contract which requires the buyer or lessee to pay the full purchase price, when the property has already been returned, may be a hard and oppressive contract, especially where the property has not been damaged and the payments already made are adequate compensation for its use. On the other hand the parties were free to make such a contract. They have expressly agreed that all sums unpaid are to be considered as liquidated damages, to compensate the seller for the breach of the terms of the contract, which he is authorized to collect. They contracted that the lessor had this right to recover and the contract is enforceable."

The general principle has been thus stated:

> "The contract is to govern; and the true question is What was the contract? Whether it was folly or wisdom for the contracting parties thus to bind themselves is of no consequence if the intention was clear. If there is no fraud, circumvention or illegality in the case the Court is bound to enforce the agreement."

Note to *King Iron Bridge Co. v. St. Louis, 10 L. R. A. 826, at 829,* and
Note to *Condon v. Kemper, 18 L. R. A. 671.*

The petitioner contends (Pp. 9 and 10 of his brief) that while the above principle may control between "the contracting parties," it ought not to control where "the lessee is not the one who will suffer by the enforcement of this provision, but his innocent creditors," and "when the rights of innocent third persons are involved." In short, he contends that it works a fraud upon the creditors.

The opinion says of this argument:

> "It is true that if the claim is allowed it will diminish the dividends to be paid to other creditors, but we are not concerned with this result. The only question presented upon this record is whether or not the claim made by the lessor is a provable one under Section 63 (a) 4 of the Bankruptcy Act of 1898." (Record, P. 13.)

and again,

> "As the agreement is one for liquidated damages, can it be said to be invalid as being a fraud on the creditors of the bankrupt (the lessee), or a preferential transfer or conveyance?
>
> "There was no evidence that the bankrupt intended to defraud his creditors or that the claimant knew of such intention, if it existed. It is, therefore, not void on that account.
>
> "It does not appear that the bankrupt was insolvent when the lease was made; and the covenant in regard to damages, if it could be said to effect a preferential transfer, was plainly not made within four months of the filing of the petition in bankruptcy." (Record, P. 14.)

It might be added that it does not appear that the lessee had any creditors when he entered into the lease, or that his future creditors made any inquiries of the lessee or lessor before extending credit, as to the provisions of the lease then in existence.

All debts absolutely owing by the bankrupt at the time of the filing of the petition, which are founded upon a contract, may be proved and allowed.

A creditor has the right to share in the distribution of the estate of his debtor unless he has been "guilty of some moral turpitude or some breach of duty whereby other creditors were deceived to their damage" constituting such a fraud as to estop him.

Collier, Vol. 2, 13th Ed. 1385.

It has been held that a trustee in bankruptcy cannot recover from a lessor rent which has been paid in advance by the lessee, where the lease contained a provision making the rent payable in advance with a further provision that the lessor might terminate the lease upon the bankruptcy of the lessee without forfeiting the rent paid in advance, and where the lessor had so terminated prior to the expiration of the period for which the lessee had paid the rent in advance. It was urged by the trustee in that case that the stipulation was invalid as "providing a penalty" and working a fraud upon the creditors.

Galbraith v. Wood, 124 Minn. 210.

Point D.

The petitioner contends (P. 10 on his brief) that "The Circuit Court of Appeals for the Sixth Circuit had exactly the same question to decide in the case of *In re Miller Bros. Grocery Co., 219 Fed. 851 (C. C. A. 6)* as was decided in this case," and that the case was decided the other way.

In that case, there was a so-called lease of a cash carrier system for the term of seven years, at $250 per year. It provided, not that bankruptcy should *ipso facto* terminate the lease and without entry by the lessor, as in the instant case, but that the lessor might upon bankruptcy of the lessee enter and terminate. It provided, not that the lessor in case of bankruptcy should "be entitled to recover damages," measured by the rent, as in the instant lease, but that "the balance of rental for the entire term shall be considered at once due and payable." The word "damages" is not to be

found in the lease. The lessee became bankrupt during the first year of the term, and the lessor took possession of the leased property and presented a claim for over $1600, the total rental for the entire term being $1750. The claim was disallowed by the Circuit Court of Appeals. The Court held that according to the true intent "the lessor is entitled to the benefit of either the accelerated maturity of rents or the possession of the carrier system, but not of both."

The Court, however, in reaching its conclusion as to the true intent of the lease, discusses the validity of a provision which would give the lessor *both* the right to take possession of the property *and* "at the same time to enforce payment of the rents." It may be conceded that where under the terms of a lease the *act of the lessor* by taking possession is what works a termination of the lease, and where the lessor is given not damages measured upon rents but "the balance of rentals for the entire term," the lessor may not *under such a lease* retake the property and also prove a claim for future rents. But that is not this case. Here, the bankruptcy of the lessee, and not any act of the lessor, terminates the lease; and here the lessor is claiming damages, and not rent.

Filene's Sons Co. v. Weed, supra.

The other Sixth Circuit case (*Lamson Co. v. Elliott-Taylor-Woolfenden Co. et al.*, 25 Fed. (2d) 4) is cited by the petitioner (P. 12 of his brief) merely because of what is said in that opinion of *In re Miller Bros. Grocery Co.*

It may be noted that neither of the Sixth Circuit cases is cited in the minority opinion in this case.

CONCLUSION.

It is therefore respectfully submitted that this case is not one calling for the exercise by this Court of its supervisory powers; that it is not of the "far reaching importance" contended for by the petitioner; that it is not "in conflict with the weight of authority"; that the claim presented is not for rent, but for liquidated damages measured by rent;

that the agreement was not a "penalty"; that being a valid claim, it is not to be disallowed as a fraud upon creditors, merely because it will diminish the dividends to be paid to other creditors; that the opinion is not in conflict with the decisions of the Sixth Circuit, as contended by the petitioner; that the First Circuit committed no error; and that there is no reason why the writ of certiorari should be granted, and why this Court should review the decision of the Circuit Court of Appeals and reverse the same.

Respectfully submitted,

GEORGE S. TAFT,
Attorney for Respondent.

T. HOVEY GAGE,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929.

NO. 48

CARL H. KOTHE, Trustee,

APPELLEE, PETITIONER HEREIN,

v.

R. C. TAYLOR TRUST,

APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF

HERBERT TURKEL, Bankrupt.

SUPPLEMENTAL BRIEF FOR THE RESPONDENT

GEORGE S. TAFT,
Attorney for Respondent.

T. HOVEY GAGE,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

NO. 48.

CARL H. KOTHE, TRUSTEE,
APPELLEE, PETITIONER HEREIN,

v.

R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF
HERBERT TURKEL, Bankrupt.

Supplemental Brief for the Respondent.

1. The lease was a two year lease.

The dissenting opinion of the Circuit Court of Appeals states (Record, page 12) that in the Referee's certificate "Neither the date nor the term of the lease is stated. For those my brethren resort to the briefs." The *opinion* states (Record, page 9) "The term of the lease was short—two years." The petition for writ of certiorari states that the lease was "for the full term of two years." It is assumed, therefore, that notwithstanding the omission in the Referee's certificate to state the term of the lease, this Court will consider the question as though the Referee's certificate had stated that it was a two-year lease. The Court below and both counsel have so dealt with it.

2. The fact that it was a short term lease may be of importance.

The dissenting opinion states (Record, page 12)

> "Appellant's learned counsel frankly and correctly conceded at the argument that, if this claim is provable, a like claim under a lease

> for forty years, terminated by the lessee's bankruptcy at the end of one year, would be provable."

Whatever view respondent's counsel may have taken in argument in the Court below, the respondent does not now concede "that if this claim is provable, a like claim under a lease for forty years, terminated by the lessee's bankruptcy at the end of one year, would be provable." This being a two-year lease, it is submitted that it is unnecessary to discuss here whether a like claim under a long or longer term lease would be provable. That the term was short seems to have been an important fact in the opinion of the Court below. "The term of the lease was short—two years." The respondent now contends that it may not necessarily follow that because this claim is provable, "a like claim under a lease for forty years, terminated by the lessee's bankruptcy at the end of one year, would be provable." The only question now presented is whether the clause under consideration in a *two-year* lease is reasonable and gives the lessor a provable claim.

3. The concrete question in the case is whether the provision under consideration in this two-year lease is upon its face so unreasonable that it must have been intended as a penalty, and that a claim for damages of $5000 should be disallowed, that being a sum equal to the rent reserved for fifteen months of the lease, the "residue of the term."

When a lessor re-enters leased premises for breach of a covenant by the lessee, and terminates the lease, he has no further claim against the lessee, where the lease contains no stipulation for damages.

Gardiner v. Butler & Co., 245 U. S. 603.

Consequently, modern leases usually contain some stipulation. Some of the common provisions are enumerated in *Louis K. Liggett Co. v. Wilson, 224 Mass. 456, 459.* An illustration is found in the lease in *Filene's Sons Co. v. Weed, 245 U. S. 598.*

The purpose of such stipulations is to protect the lessor against the loss of the "benefit of his bargain."

(Such stipulations are of course unnecessary when there are responsible guarantors for the performance by the lessee of all of his covenants, a well known common requirement of lessors.)

Such stipulations, when reasonable, are enforceable against the lessee, and permit the lessor to share with the lessee's other creditors in the distribution of assets under receivership proceedings.

Filene's Sons Co. v. Weed, supra.

Under the bankruptcy law, the only claims provable are those in existence at the time of the filing of the petition.

30 Sts., chap. 541, §63.
Zavelo v. Reeves, 227 U. S. 625.

Where a lease provides that upon bankruptcy the lessor *may enter and terminate* the lease, with a further provision for damages in that event, the lessor has no provable claim, as the claim is not in existence at the filing of the petition.

Slocum v. Soliday, 183 Fed. 410.

Under the lease in the case at bar, bankruptcy terminated the lease, the claim for damages arose "forthwith" and was in existence at or before the filing of the petition in bankruptcy, and was not contingent. The claim was therefore provable, if it was a valid and enforceable claim against the lessee. (Cases cited in the Opinion of the Circuit Court of Appeals, Record, page 9.)

The Opinion states (Record, page 9):

> "It cannot be said that the amount of damages to be recovered is so largely in excess of any actual damage that the lessor may suffer that it must have been intended as a penalty and its recovery would be unconscionable."

The respondent contends that the authorities cited on pages 5 and 6 of its brief in opposition to the petition, and in the Opinion of the Circuit Court of Appeals (Record, page 10) support that conclusion. If the lessor is unable to relet the premises for any part of the "residue of the term" (in this case fifteen months) after the termination of the lease, or to make any valuable use of them, then the damages agreed upon would not *at all* exceed the actual damage. The actual damage cannot be known until the date of expiration of the term. How can it be said that the stipulation upon its face was intended as a penalty when the actual damage *may* equal the stipulated damage?

In the case of *Bedard v. Ransom, Inc., 241 Mass. 74*, cited on page 6 of Respondent's Brief in opposition to the petition, it is difficult to see how the actual damage could possibly have amounted to as much as the stipulated damage, and yet the contract was held to be enforceable.

It may be noted that "the residue of the term" might be much longer in a long term lease than in a two year lease, and that there would be a greater *probability* in such case that the vacant premises might prove of some value to the lessor. Whether a similar provision in a *long term* lease might be held unreasonable, is not here involved.

Respectfully submitted,

GEORGE S. TAFT,
Attorney for Respondent.

T. HOVEY GAGE,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

No. 48.—October Term, 1929.

Carl H. Kothe, Trustee, Petitioner, vs. R. C. Taylor Trust. | On Writ of Certiorari to the United States Circuit Court of Appeals for the First Circuit.

[January 6, 1930.]

Mr. Justice McReynolds delivered the opinion of the Court.

April 20th, 1927, respondent—the R. C. Taylor Trust—leased to one Turkel certain real estate, reserving rent at the rate of $4,000 per annum. The meager record before us does not affirmatively show the length of the term, but we accept the statement by counsel for both sides that it was two years. The lease contained the following provision—

> "The filing of any petition in bankruptcy . . . by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term thereof."

Turkel having been adjudged bankrupt the lessor filed proof of debt for $5,000 demanded as "damages for breach of lease . . . that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term."

The referee disallowed the claim "for the reason that the proof is based on damages for the amount of rent running from the date of the filing of the petition to the end of the term of the lease, no part of such claim being for any rent which had accrued at the time of the filing of said bankruptcy petition." The District Court affirmed his action; but the court below held the claim valid and al-

lowable under Section 63 (a) 4 of the Bankruptcy Act, 1898, 30 Stat. 563 (U. S. C. A. Title II, Chap. 7, Sec. 103).

The Trustee, petitioner here, maintains that the quoted provision of the lease imposed a penalty and did not express any lawful purpose to fix the liquidated damages which might follow failure to perform. On the other hand, the respondent insists that in view of the length of the term the agreement must be regarded as one for liquidated damages and therefore unobjectionable.

Sun Printing & Publishing Assn. v. *Moore*, 183 U. S. 642 and *United States* v. *Bethlehem Steel Co.*, 205 U. S. 105, 119, point out principles applicable to enforcement of contracts providing for payment of definite sums upon failure to perform. The courts are "strongly inclined to allow parties to make their own contracts, and to carry out their intentions, even when it would result in the recovery of an amount stated as liquidated damages, upon proof of the violation of the contract, and without proof of the damages actually sustained. . . . The question always is, what did the parties intend by the language used? When such intention is ascertained it is ordinarily the duty of the court to carry it out." And see *United States* v. *United Engineering Co.*, 234 U. S. 241: "Such contracts for liquidated damages when reasonable in their character are not to be regarded as penalties and may be enforced between the parties." But agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced. This circumstance tends to negative any notion that the parties really meant to provide a measure of compensation—"to treat the sum named as estimated and ascertained damages."

Here, we find the lessee in a lease for two years agreeing that the mere filing of a petition in bankruptcy against him shall be deemed a breach and thereupon, *ipso facto*, it shall be terminated and the lessor shall become entitled to re-enter also to recover damages equal to the full amount of the rent reserved for the remainder of the term. The amount thus stipulated is so disproportionate to any damage reasonably to be anticipated in the circumstances disclosed that we must hold the provision is for an unenforceable penalty. The parties were consciously undertaking to contract for payment to be made out of the assets of a bankrupt estate—not for something which the lessee personally would be required to discharge. He,

therefore, had little, if any, immediate concern with the amount of the claim to be presented; most probably, that would affect only those entitled to share in the proceeds of property beyond his control.

The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands based upon adequate consideration. Any agreement which tends to defeat that beneficent design must be regarded with disfavor. Considering the time which the lease here involved had to run, nothing else appearing, it seems plain enough that the real design of the challenged provision was to insure to the lessor preferential treatment in the event of bankruptcy. The record discloses no circumstance sufficient to support a contrary view. If the term were much shorter, or there were facts tending to disclose a proper purpose, the argument in favor of the lessor would be more persuasive.

The decree of the court below must be reversed. The judgment of the District Court will be affirmed and the cause remanded there for further appropriate proceedings.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.